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Many Canadians have taken a wait-and-see view on economic recovery.

But, even though it may be a long march to shake off memories of the bears, it's wise to watch for suitable investment opportunities while other investors are lying low. Let's talk about keeping your portfolio well-poised to potentially capture the gains of an improving climate.



FOCUS ON INVESTING

Could oil add fuel to your portfolio?

If oil is one of those investments you've avoided in the past because of its volatility, it might be time to take a second look at it as a potential growth investment for a small part of your portfolio.

Unlike last year, when oil prices rose to US\$ 147 a barrel — and then slumped 74% by year-end — so far 2009 has seen oil prices that are, comparatively, low and steady.

Prices low and poised to grow

Once economies around the globe begin their recovery from the financial crisis, demand for oil will also grow — and consequently prices will as well. It's not likely to be immediate, since the infrastructure for production is old and the credit crisis derailed new development.

However, the coming years could bring big gains, as infrastructure is developed

and as the middle class grows in countries like China and India.

Many ways to invest

Large and small energy companies represent more than a quarter of the S&P/TSX Composite Index. In addition, diversified Canadian equity funds are typically big energy investors. There are also numerous specialty mutual funds that invest in energy products and exchange-traded funds that track the price of oil or oil-related indexes.

If you're interested in exploring oil for your portfolio, professional advice can help you determine the exposure that would best suit your investing goals, your risk tolerance, and your time horizon. ■



Help protect purchasing power with real return bond funds

In the past few years, inflation has only attracted attention because of historically low rates. But currently, there is growing concern that inflation will accelerate once the global economy begins to recover, spurred by various government stimulus programs.

Economists are calling it “the great rate debate.” Will interest rates go up sooner, or later? If higher inflation does manifest itself, it’s an opportune time to explore investments with inflation protection that are good for the long term. Namely, real return bond funds.

Real return counts

When evaluating investments, we typically focus on what’s known as “nominal” return. If you invest \$1,000 and it grows to \$1,040 after a year, your nominal return was 4%. But if inflation was 3%, you really gained just 1% in purchasing power. This figure is known as the “real” return. The greater the inflation rate, the harder it is to build wealth for the future. (See below for the effects of inflation on your dollar.)

After the high inflation rates of the 1970s and 1980s, the governments of Canada and several provinces began issuing real

return bonds as a source of stable long-term funding. These bonds protect investors from inflation by linking both principal and interest to the consumer price index. This means that real return bond performance tracks the rate of inflation.

Because real return bond funds hold real return bonds, they also carry inflation-risk protection, and tend to be less volatile than traditional long-term bond funds. However, it also means that real return bond funds typically have more modest growth potential than regular bond funds. And, like any mutual fund, they can go down in value.

What’s available in Canada

A number of Canadian mutual fund companies offer real return bond mutual funds. The minimum investment for most is well under \$1,000. In addition to Canadian issues, these funds may hold foreign-currency real return bonds from the U.S. and European governments.

Real return bond mutual funds should be held in a registered plan, such as an RRSP, an RRIE, a registered education savings plan, or a tax-free savings account. Because both principal and interest are adjusted to reflect inflation, the adjustment to the fund’s principal must be included as income every year, even though you don’t receive the bond income until the bonds are sold or mature.

If you’re interested in an investment for long-term investors in inflationary times, professional advice can help determine whether they might have a place in your portfolio. ■

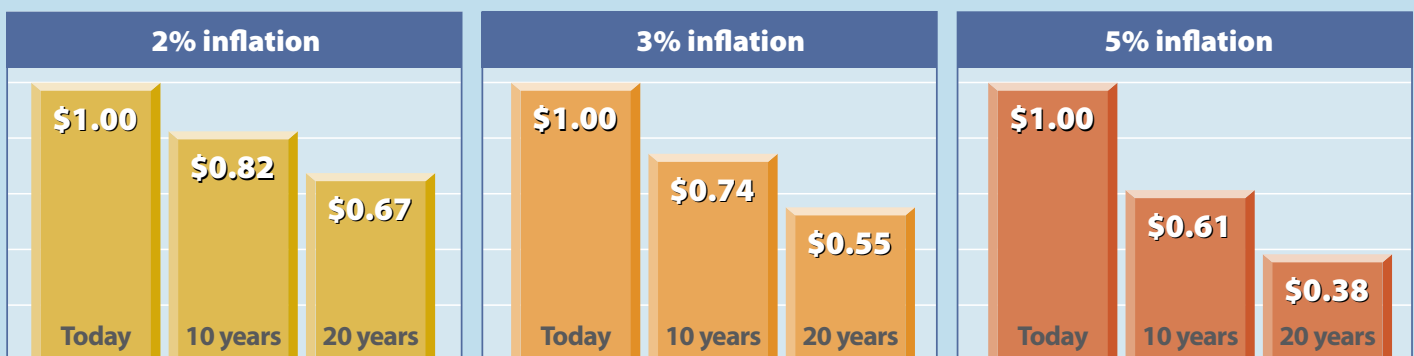


EYEOPENER

graphic evidence of how investing works

Even low inflation can erode your dollar power over time

The effects of even modest inflation can devastate your purchasing power over several years. Watch the shrinking loonie at 2%, 3%, and 5% inflation over a decade, then 20 years. Protection against inflation is a key consideration when investing for long-term goals.



Source: Bank of Canada Inflation Calculator

INVESTMENT PLANNING

Snowbirds, plan for trading while you're away

Planning a long winter getaway to the U.S. sunbelt? Include in your preparations an investigation to see if it will be possible to phone or fax trading instructions from your winter home. Securities regulators in different states vary widely on whether a Canadian advisor can accept instruction from someone in that state. Not all products/securities can be traded either. Some states are more flexible with your management



of registered investments; others require your dealer to file notice with the state for a fee. If you're not allowed to do so from your winter home, make sure to meet with your representative ahead of time. ■

EDUCATION SAVINGS

There's still time to get the CESG

If you haven't done so already, plan now to make your Registered Education Savings Plan (RESP) contributions before December 31. It's easy to forget because RRRSPs have a 60-day grace period at the beginning of next year, while RESPs don't. Making an RESP contribution by year-end means your child's plan will get the Canada Education Savings Grant (CESG) without delay. Remember, the Canada Education Savings Grant will give you 20 cents for every dollar on your first \$2,500. It can be even more, depending on your income. ■



FINANCIAL PLANNING

School costs go waaay up

Average tuition for full-time undergraduate enrollment at a Canadian university rose by 3.6% to \$4,724 for the school year from 2007 to 2008, according to Statistics Canada. Tuition fees have risen at almost twice the pace of inflation over the past decade — an average annual rate of 4.4% versus 2.3% for the consumer price index. If this continues, it will make saving for your children's post-secondary education even more important. ■



FINANCIAL CLASSROOM

your guide to the basics and how to benefit

Spousal loans

A spousal loan is a legitimate way for a couple to save tax on investments. While it would be great if, say, higher-income Ginger could simply give stay-at-home-dad Fred money to invest (to take advantage of his lower marginal tax rate), attribution rules prevent that by taxing Ginger for any income earned on the investment. Here are the details.

What it is

A loan from one spouse to another, backed up by a promissory note that is signed by both parties, showing the loan's date, amount, interest rate, and repayment terms.

How it works

Ginger's marginal tax rate is much higher than Fred's. She lends him money to invest, and must charge him interest either at a commercial bank rate or the Canada Revenue Agency's prescribed rate in effect when the loan is made, whichever rate is lower. Fred must pay Ginger interest for the year no later than January 30. Ginger must report the interest as income, but Fred can claim it as a tax deduction.

Why it matters

Fred pays the tax on the investment earnings, and the amount is less than Ginger's would be because of his lower tax rate. While Ginger has to report the interest that Fred pays her as income, the CRA's prescribed rate is quite low as it reflects Treasury bill yields. As a couple, they save money because the tax saved on the investment earnings should easily exceed the interest cost. In addition, the loan (and its low rate) can be locked in. Note that this can also be done with minor children through a trust to save tax on interest and dividends; there is no attribution for capital gains on money given to a minor.

Optional tax returns could mean big savings for estates

Here are some little-known opportunities for executors: There are three additional tax returns that may be able to help minimize tax costs on the estates they're responsible for.

The mandatory final income tax return, filed to the Canada Revenue Agency, is something that most people facing executor duties are already aware of. It covers income from January 1 to the date of the individual's death. The three optional returns are known as "rights or things," "partner or proprietor return," and "testamentary trust income return."

The saving comes in by spreading income between the final return and at least one other — because each return has its own set of graduated tax rates.

How each return works

Each optional income tax return has a purpose.

- A **rights or things return** is most widely used, and is specifically for payments that were due, but not yet received at the time of death. For example: salary, commissions and accrued vacation pay, dividends and interest earned but not received, billings for work in progress by a sole proprietor, and farm or fishing accounts receivable.

- A **partner or proprietor return**, as the name implies, is for the unincorporated self-employed — if their fiscal year did not match the calendar year. This return can report income for the period between the end of the past fiscal year and the date of death. Suppose Sydney's business had a

March 31 year-end and she died on September 30. This return would cover income from April 1 through September.

- A **testamentary trust income return** is for income received from a trust established by someone else's will. Suppose Sydney's husband died five years ago and he left a spousal trust to help support her. That income can be reported — and taxed separately — on this return.

Spread the wealth

Here's an example of the potential tax savings.

Suppose Martin had \$100,000 of income in his final year and did not qualify for any special tax breaks, such as the age credit. Assuming a marginal tax rate of 40.7%, income tax would total close to \$26,000. If, however, \$80,000 could be reported on the final return and \$20,000 on a rights or things return, the tax bill would fall below \$20,000. That's a 23% reduction.

Plus, certain tax credits can be claimed on each return: the basic personal amount, age amount, spouse or common-law partner amount, amount for an eligible dependant, amount for infirm dependants age 18 or older, and the caregiver amount.

Naturally, a tax break this advantageous has constraints. Only certain types of income qualify. To find out more, check the Canada Revenue Agency's guide *T4011 — Preparing Returns for Deceased Persons* available at www.cra-arc.gc.ca. And, of course, make sure your own executor is aware of this. ■

Boost benefits of tax-loss harvesting

FARMERS AREN'T THE only ones harvesting in the fall. Autumn kicks off "tax-loss selling season" as investors harvest capital losses to save tax on current and prior capital gains.

Here's what you need to know to maximize your harvest.

You receive a capital loss when you sell a mutual fund, stock, or other financial asset for less than you paid. This loss is first applied to offset tax due on gains realized this year. Any unused loss can be applied against gains going back three years to generate a refund of tax already paid, or be kept for future use.

But what if you want to stay in a loss investment to capitalize on the future economic recovery? After all, you can't buy it back. If you buy an asset back within 30 days of selling it, or if you sell an asset you've held for less than 30 days, the Income Tax Act's "superficial loss" rule disallows the tax break.

There is a way to both trigger a capital loss and stay invested.

Though you can't repurchase the same fund or stock for 30 days, you are permitted to buy a similar one. For example, you could replace one Canadian equity mutual fund with another. Look for a fund with very similar investment objectives and portfolio.

One consideration: Make sure the tax savings exceeds commission costs or fees. In particular, if your mutual funds have redemption fees, ask us to check funds in the same family for a no-cost switch. ■

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